



## The City of Lynchburg,

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OFFICE OF THE  
CITY MANAGER

TO: The Honorable City Council

FROM: L. Kimball Payne, III, City Manager  
Bonnie Svrcek, Deputy City Manager

SUBJECT: *Proposed FY 2003 Budget*

DATE: March 14, 2002

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### Introduction

We submit for City Council's consideration the *Proposed FY 2003 Budget* for the City of Lynchburg. The budget includes the General, Capital, Airport, Water, Sewer, and Solid Waste Management Funds, as well as other minor funds, and totals \$192.4 million. The proposed budget was developed in an environment of national recession, state fiscal crisis, and the special challenges facing older central cities in the Commonwealth. Limited resources and the inevitability of reduced support from the state government preclude the establishment of new programs, the hiring of additional personnel or salary increases for City employees. Nevertheless, the proposed budget attempts to comply with adopted Financial Management Policies and to advance City Council's vision for Lynchburg and its citizens. The *Proposed FY 2003 Budget* is balanced using current tax rates to finance the General Fund. The Water, Sewer and Solid Waste Management enterprise funds require rate increases to balance required expenditures while the Airport Fund will require an increased operating subsidy.

### Budget Development

The development of the *Proposed FY 2003 Budget* commenced with questions still unanswered regarding the status of the current year budget. Reflecting the national recession, revenues from the sales, meals, business license and lodging taxes are flat to slightly less than projected. In addition, reduced state revenues and the failure of the 2001 General Assembly to adopt amendments to the FY 2001/2002 state budget have left localities unsure of the level of state support they can expect in FY 2002. Already, there have been reductions in HB599 funding, ABC tax revenues, and support for public education and, with the Commonwealth facing a deficit of nearly \$4 billion over the next two biennia, it is apparent that state support for local services, mandated or otherwise will be reduced. Because General Assembly action on the FY 2003/2004 Biennial Budget was not completed prior to the development of the City budget, estimates of state revenues were based only on past history, reductions already experienced, and limited information regarding the different state budget proposals under consideration.

In the abstract, budget development is guided by two principal sets of guidelines, the Financial Management Policies and priorities adopted by City Council.

### Financial Management Policies

City Council first adopted Financial Management Policies in 1999 and has amended and reaffirmed them as appropriate. The policies address such areas as adopting a balanced budget, the appropriate fund balance to maintain, restrictions on its use for recurring operating expenses, debt management and the establishment of contingency reserves to address unexpected circumstances. If followed, sound financial management policies should do the following:

- Contribute significantly to the City's ability to insulate itself from fiscal crisis and economic disruption
- Enhance short-term and long-term financial credit ability by helping to achieve the highest credit and bond ratings possible
- Promote long-term financial stability by establishing clear and consistent guidelines
- Direct attention to the total financial picture of the City rather than single issue areas
- Promote the view of linking long-term financial planning with day to day operations
- Provide the City Council and the citizens a framework for measuring the fiscal impact of government services against established fiscal parameters and guidelines
- Ensure that the organization is sufficiently resourced to perform mandated responsibilities
- Provide a foundation for evaluating financial analysis and condition

The Financial Management Policies are included in the General Budget Information section of the budget document.

### City Council's "Few Vital Priorities"

In November 2000, City Council identified ten priorities upon which City staff should focus its resources. The priorities were reaffirmed at a Council retreat in October 2001 and are as follows:

- Create a Superior Education Community
- Increased Real Estate Value
- Fiscal Responsibility
- Economic Development
- Maintain Excellent Core Services
- Infrastructure (adequacy of building, street, bridges maintenance, repairs, capital improvements)
- Downtown Development/Redevelopment
- Council Boards and Commissions Appointees
- Reduce Unfunded Mandates
- Families

Frankly, the *Proposed FY 2003 Budget* does not support any new initiatives to advance Council's priorities. It does attempt, however, to maintain current efforts.

During the development of the proposed budget we struggled with what we see as a fundamental dichotomy of modern civics. Citizens have high expectations about the level and quality of government services yet they are unwilling to support tax increases to pay for those services. Not only are local governments expected to provide the core services of public safety, education and transportation but other services that enhance a community's quality of life, such as libraries, parks and recreation, museums, and quick response to customer requests are also desired. At the same time, significant state and federal mandates require local dollars for the school system, social services, Constitutional offices, solid waste, water and sewer, corrections and juvenile detention. Finally, in older cities such as Lynchburg, there is a concentrated need for services to many less advantaged residents and a staggering cost to maintain an aging infrastructure of roads, schools, public buildings, and utilities.

Budget development and the deliberations that follow allow a community to assess the mix and level of services that it expects its local government to provide balanced against its willingness to pay for them. To those who claim that government is inherently wasteful, prone to uncontrolled growth and characterized by many opportunities to reduce spending, we offer full participation in the budget process. The services, programs and processes that make up local government are the result of many incremental, individual decisions made by governing bodies and administrators over the years. An annual re-examination of that mix and the elimination of services, programs and processes that are not mandated and that provide little relative value to the community should be a fundamental component of the budget process.

### Budget Guidelines

The *Proposed FY 2003 Budget* was developed using a modified zero-based process. The zero-based process requires each department to prepare a budget request that reflects the actual costs of performing its responsibilities as if it was being done for the first time. Merely proposing incremental additions to a previous year's budget is not acceptable. In a zero-based approach, the fact that a dollar was spent the year before is not relevant to a request for that same dollar in the new fiscal year. Each dollar must be justified as supporting the functions and operations of the department. During the development of the FY 2002 Budget, approximately half of the City departments utilized the zero-based approach. This year all departments were asked to prepare their budget requests from a zero base.

### Balancing the General Fund Budget

A compilation of budget requests, including a proposed salary increase for City employees and level funding of the school system, when compared to estimated revenues in the new fiscal year, indicated a gap of approximately \$10 million. Fully funding the initial requests received by the Budget Office from General Fund departments would have required a Real Property Tax Rate of \$1.51 rather than the current rate of \$1.11 for each \$100 of assessed value. Because any tax increase was out of the question, what followed was a line item by line item evaluation of each department's budget that provided a verification of the zero-based approach. Each line item was evaluated with respect to the

need or requirement for the proposed expenditure, the anticipated value to be gained by the expenditure, and the reasonableness of the request based on prior years' history.

Keeping the Financial Management Policies and City Council's goals in mind, the following practical priorities were also used to develop the *Proposed FY 2003 Budget*:

- Fund debt service
- Fund mandated programs
- Maintain a fund balance in accordance with fiscal policy
- Preserve employee benefits
- Provide appropriate compensation for City employees
- Fund school construction at a level previously committed to by City Council
- Replace essential equipment, especially vehicles and computers
- Maintain existing facilities
- Provide excellent core services
- Provide quality customer service

The extent to which the proposed budget addresses these priorities, given the limited resources available, will be a matter for discussion during budget deliberations.

In balancing the *Proposed FY 2003 Budget* a number of difficult decisions were made. They included:

- A reduction to General Government requests (\$800,000)
- A reduction to Public Safety requests (\$700,000)
- A reduction to the Street Maintenance request (\$1.1 million)
- The elimination of a proposed 3% general salary increase (\$1.2 million)
- A reduction to School Operations to reflect declining enrollment (\$750,000)
- A reduction to the Fleet Replacement Transfer request due to the decision to bond finance large pieces of fire/rescue equipment (\$900,000)
- Elimination of the transfer to the Economic Development Strategic Initiatives Reserve (\$560,000)
- Elimination of the transfer for Designated Street and Bridge Repairs (\$500,000)
- Reduction in the budgeted Reserve for Contingencies (\$600,000)
- Elimination of the balance for a 27<sup>th</sup> payroll (\$580,000)
- Elimination of the Non-profit Balance (\$560,000)
- The elimination, or deferred funding, of a number of previously authorized positions including Assistant City Manager, Fiscal Planner, Volunteer Coordinator, an Accountant III, and a Project Manager
- A recommendation to only partially fund two (2) of twenty-one (21) requested new positions

In the end, revisions to revenue estimates, actions to reduce departmental requests and adjustments to reserves more than closed the initial budget gap, with a net of approximately \$2.5 million. Subsequently, \$600,000 was restored to the Reserve for Contingencies and \$400,000 was shifted to pay as you go capital projects. This resulted in a projected General Fund Balance on June 30, 2003 that will be \$1.5 million more than the policy target. These funds can provide a buffer if state

revenue reductions are more than anticipated or, can give City Council a measure of flexibility as it deliberates the budget proposal and considers requests to restore reductions made by the Managers' Office. One caveat, however, must be kept in mind. The *Proposed FY 2003 Budget* complies with the financial management policy of matching ongoing expenditures with annual revenues. Utilizing fund balance to cover recurring costs is inconsistent with the financial management policies and would require actions to either increase revenues or reduce recurring expenditures in subsequent years.

### The Budget Document

Budget document enhancements include the consolidation of some separate budgets to group closely related activities; for example, City Council, the Clerk of Council, the City Managers' Office and the Legislative Liaison are combined under the category of Council/Manager Offices. Major categories within the General Fund are grouped more in accordance with guidance provided by the State Auditor of Public Accounts for comparative cost reporting. The document also includes revised organization charts for each department/division that more clearly show which positions are supported by local revenues and which are supported by other means such as federal or state aid or grants. In addition, the document, for the first time, includes recurring grant revenues, expenditures and positions in departmental budgets to give a clearer picture of total revenues and expenditures for City operations. It also lists current grants that may be one-time in nature. Another change is that individual departments will no longer budget for buildings and grounds maintenance. The principle is that City departments are tenants in their space and should not be held directly responsible for maintenance and repair. Accordingly, costs for such work is programmed as a lump sum in the Buildings and Grounds Division of Public Works. An additional category for Dues and Memberships was added to the Departmental summary sheets; these expenditures were previously shown in the Miscellaneous category. Along these same lines, several items have been transferred from Non-departmental into the departments that are responsible for such expenditures (ex., banking services was moved to the Financial Services Department). Finally, under each General Fund department is a comparison of the Managers' recommendation for FY 2003 to the *FY 2002 Adopted Budget* and a listing of major items requested by the department but not recommended for funding.

### **General Fund Revenues**

Total General Fund revenues for FY 2003 are projected to be \$116.8 million, representing an increase of \$2.8 million or 2.4% above the *Adopted FY 2002 Budget*. General Fund revenues consist of both Dedicated Revenues (\$24 million) and Non-dedicated revenues (\$92.8 million).

### Dedicated Revenues

Dedicated revenues are those revenues that are specifically designated by the Federal, State or City government to be used for specific programs. Overall, dedicated revenues are projected to increase \$2.5 million or approximately twelve percent (11.6%) based on information that is tentative at best. This increase is primarily attributable to including recurring grants (\$1.0 million) for the first time in the annual budget as well as projected increases in public assistance from the federal and state government (\$700,000). It is quite possible that once the General Assembly acts on the FY 2002 "Caboose" Bill, state revenues in the current fiscal year will be less than anticipated. Payments for Constitutional

officers, social services, juvenile services, libraries, jails and road maintenance seem especially susceptible to reductions based on the various budget proposals under consideration in Richmond. One of the fundamental issues that may need to be addressed once a state budget is adopted will be if and the extent to which the City should try to substitute local funds for reduced state revenues.

### Non-Dedicated Revenues

Non-dedicated revenues, or those revenues that can be used at the City's discretion, are projected to increase slightly (approximately \$325,000) from the *FY 2002 Adopted Budget*. Over eighty percent (82.3%) of non-dedicated revenues and sixty-five percent (65%) of total General Fund revenues are generated by six local taxes, the Real Property Tax (\$29.8 million), the Personal Property Tax (\$16.1 million, including the state reimbursement), the Local Sales Tax (\$11.1 million), the Meals Tax (\$6.9 million), the Business License Tax (\$6.4 million), and Consumer Utility Taxes (\$6.1 million). Other than the property taxes, these revenue sources are especially vulnerable to economic downturns.

Real Property Tax revenues are projected to increase by approximately \$1.1 million, or about two percent (1.9%). Because FY 2003 is not a reassessment year, the increase is attributed to new construction or land division in the City and Council's action to amend the City Code and allow the proration of real property taxes on newly developed property. The code amendment enhanced revenues from this source by about \$200,000. Nevertheless, in the last year the City has not seen significant new commercial development such as that previously experienced in the Ward's Road corridor. Real Property Tax revenue projections are adjusted for a historically uncollectable percentage (2%), tax relief for the elderly and rehabilitation tax credits. For budgetary discussions, each penny on the Real Property tax rate of \$1.11 will generate approximately \$270,000. This revenue source represents nearly one-third (32.2%) of General Fund non-dedicated revenues.

Personal Property Tax revenues are projected to increase slightly, by approximately \$300,000 or 1.7% to \$15.6 million. This includes the state reimbursement for 70% of the tax on private vehicles. Growth in Personal Property, Business Property and Machinery & Tools assessments in the coming year is estimated to be 2%. This revenue category represents nearly seventeen percent (16.8%) of General Fund non-dedicated revenues.

Public Service Corporations Tax revenue is projected to increase approximately \$200,000 or nearly ten percent (9.6%) to \$2.3 million. This revenue is assessed by the State.

Consumer Utility Taxes revenues are projected to increase slightly, by approximately \$78,000 from FY 2002, to \$6.1 million, reflecting the economy and a trend to warmer winters.

Local Sales Tax revenue is the third largest portion of non-dedicated revenues to the City, representing twelve percent (12.1%) of those funds. Unfortunately, it is also a revenue source that is especially elastic depending on the state of the economy. Projections indicate a reduction of revenue from the Local Sales Tax of approximately \$500,000 from FY 2002 to \$11.2 million. This 4.5% loss is significant.

Fortunately, Meals Tax revenues have not followed the downward trend of Local Sales Tax, although they are not projected to have significant growth. Several new restaurants have opened in the

City or are under construction and this revenue may increase as the recession weakens. The revenue estimate of \$7.0 million represents 7.5% of the General Fund non-dedicated revenues.

Business License Tax revenues of \$6.4 million reflect a slight decrease of \$90,000, or just under one percent (1.4%) from the current year. This source makes up nearly seven percent (6.9%) of General Fund non-dedicated revenues.

The Other Local Taxes category makes up approximately \$5.6 million of the FY 2003 revenue stream, a reduction of \$200,000 from the current year. This category includes right of way fees (\$300,000) franchise license fees (\$500,000), electricity and gas consumption taxes (\$350,000), motor vehicle decals (\$1.3 million), bank stock taxes (\$1 million), recordation taxes (\$250,000), tobacco taxes (\$500,000), amusement tax (\$250,000), and lodging tax (\$1.1 million). Most of these revenues are expected to show little change from FY 2002 to FY 2003.

Other revenue sources are projected to fall slightly in FY 2003. Of significance is Interest on Investments, down \$600,000 to \$900,000, reflecting universally lower interest rates. Charges for Services are projected to generate \$1.1 million, basically unchanged from FY 2002, and Permits, Fees, and Licenses are projected to remain steady at approximately \$600,000.

### Potential Revenue Enhancements

Over the last year a Revenue Enhancement Team has explored possible initiatives to increase City revenues without increasing taxes. A wide array of ideas was developed and was shared with City Council in a separate document. Of the many suggestions, the following seem to be worth pursuing first:

- Broaden the auditing of various taxes such as meals, lodging, BPOL, Machinery & Tools
- Greater collaboration with Schools for joint purchasing including one purchasing card
- Create an incentive for employees not to use sick leave
- Consider the implementation of annual real estate assessment
- Have the collection of decal fees coincide with payment of personal property taxes
- Evaluate the cost-benefit of engaging a cost-recovery consultant to audit major City utility accounts

### **General Fund Expenditures**

Proposed General Fund expenditures of \$118.0 million represent an increase of \$2.3 million or nearly two percent (1.99%) over the *FY 2002 Adopted Budget*. For comparison purposes, FY 2003 expenditures should be reduced to reflect the inclusion of recurring grants (\$1,000,000) in the *Proposed Budget*. Doing that, *Proposed FY 2003 Budget* General Fund expenditures reflect an increase of \$1.3 million or just one percent (1.1%) over the *FY 2002 Adopted Budget*. The General Fund finances all government activities with the exception of the Airport, Solid Waste, Water, and Sewer operations. All funds contribute to the operations of the Fleet Internal Services Fund. A comparison of each of the General Fund operating departments as a percentage of total General Fund expenditures demonstrates the impact of these service areas on the entire proposed spending plan.

**Expenditures as a Percent of Total General Fund Expenditures**

	<b>Proposed FY 2003 General Fund Expenditures</b>	<b>Percent of General Fund</b>
General Government	\$9,196,931	7.8%
Judicial Administration	3,694,933	3.1%
Public Safety	22,333,186	18.9%
Public Works	13,551,244	11.5%
Health and Welfare	13,555,320	11.5%
Parks, Recreation and Cultural	3,688,705	3.1%
Community Planning and Development	1,841,131	1.6%
Civic, Community and Regional Organizations	1,359,178	1.2%
Non-departmental	6,213,972	5.3%
Transfers	35,843,808	30.4%
Reserves	1,200,000	1.0%
Debt Service	5,589,200	4.7%
<b>TOTAL GENERAL FUND</b>	<b>\$118,067,608</b>	<b>100%</b>

**General Government** includes Council/Manager Offices, City Attorney, Budget, City Assessor, Commissioner of the Revenue, Communications & Marketing, Customer Service, Financial Services, Human Resources, Information Technology, Internal Audit, Electoral Board, Registrar and Treasurer. **Judicial Administration** includes the Circuit, District and Juvenile and Domestic Relations Courts, the Clerk of the Circuit Court, Commonwealth's Attorney, Magistrates Office, Sheriff and Court Services Unit. **Public Safety** includes the Police Department, the Fire and EMS Department, the Animal Warden, and Emergency Communications. **Public Works** includes Administration, Engineering, GIS, Buildings and Grounds, Snow Removal and the Streets and Traffic Divisions. **Health and Welfare**, includes Social Services and Juvenile Services. **Parks, Recreation and Cultural** includes Parks and Recreation, the Library, and Museum system. **Community Planning and Development** includes Planning, Neighborhood Services, Inspections, and Economic Development.

**Civic, Community, and Regional Organizations** are groups that provide services to the City outside of general government activities. While not all of the groups proposed to be funded in this section are non-profits, many of them fall into this category. In 1999, City Council adopted a Non-profit Policy that could provide a portion of the undesignated fund balance over the 10% target for non-profit agencies. The policy also states that agencies that were funded in the FY 2000 budget would be grandfathered into the budget at the FY 2000 budget level rather than having to compete with other agencies for the pool of funds allocated following completion of the City's annual audit. Since adoption of the policy, no new funding has been provided for non-profits. While requests for new funding have been received, none are recommended for funding in the *Proposed FY 2003 Budget*. Furthermore, it is recommended that the Non-profit Policy be rescinded and that funds previously set aside be utilized in another manner.

**Non-departmental** includes those miscellaneous components of the City budget that generally do not fit nicely into an individual departmental budget but are widespread throughout, such as medical



and dental costs and a general salary increase if programmed. **Transfers** include payments from the General Fund to other funds as a subsidy or payment for services.

### Significant Increased Expenditures

Although the proposed budget is basically unchanged from the current year, there are a number of additional expenditures that bear mention:

- Additional funding is provided to support the replacement of personal computers (\$70,000)
- Expenditures for Building Maintenance are increased to reflect the removal of maintenance and repair costs from individual departments (\$400,000)
- Funds for Street Maintenance are increased (\$350,000)
- Increased costs for Public Assistance (\$500,000)
- Support for the relocation of Museum staff and exhibits from the Old Courthouse (\$30,000)
- Increased prisoners and per diem cost at the Blue Ridge Regional Jail (\$300,000)
- Increased costs of retiree health benefits (\$150,000)
- Funding to cover an anticipated 12% increase in active employee health benefits (\$240,000)
- Increased support for the Greater Lynchburg Transit Company (\$40,000)
- An increase in the transfer to the Airport Fund (\$200,000)
- Increased funding for fleet replacement (\$120,000)
- Partial funding (three months) of two custodian positions for the J.W. Ould Building (\$20,000)

### City Schools Local Contribution

At the time of preparation of this proposal, the Lynchburg City Schools had not yet forwarded a request for local funding in FY 2003. Although the amount of state support for the school system is expected to remain flat or fall, we cannot recommend that local resources be used to replace those funds. Funding in an amount of \$31.2 million is proposed for operations and debt service. Although this amount is intended to maintain the current local per capita support of \$3000 per student it does represent a decrease of \$750,000 (2.8%), reflecting an expected enrollment loss of 250 students.

### Capital Construction

Ideally, a portion of the Capital Improvement Program should be funded each year on a “pay as you go” basis. Beginning in FY 2001, a portion of the fund balance above the targeted 10% of General Fund Revenues was allocated to pay-as-you-go capital construction for those smaller projects and/or projects that have a life of less than 20 years. The *Proposed FY 2003 Budget* provides nearly \$1.2 million from the General Fund for capital construction compared to approximately \$900,000 in FY 2002.

Street & Utility Extensions for Economic Development	\$150,000
General Development Support for Economic Development	\$200,000

## FY 2003 Proposed Budget

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Furniture & Equipment for 822 Commerce Street (Human Services)	\$528,000
Various small Parks projects in support of neighborhood improvement	\$355,000

### Debt Service

Debt service in the General Fund is projected to increase approximately \$300,000 or 5.7% in anticipation of borrowing for City capital projects. The City finances a large component of the Capital Improvement Program with general obligation bonds. FY 2003 debt service as a percent of operating expenditures is projected at 8.46%, well within the 10% target.

### Reserves

The *Proposed FY 2003 Budget* significantly reduces other reserves that have been traditionally set aside to address capital projects and contingencies. A comparison between the *Adopted FY 2002 Budget* and the *Proposed FY 2003 Budget* follows:

	<u>FY 2002</u>	<u>FY 2003</u>
Reserve for Strategic Initiatives	\$547,804	0
Reserve for Accrued Compensation	125,000	0
Reserve for Streets and Bridges	450,000	0
Reserve for Public Works	350,000	0
General Fund Reserve for Contingencies	964,086	\$1,200,000
Self Insurance Reserve	0	0

The City's Financial Management Policies call for the establishment of a Reserve for Strategic Initiatives to support economic development activities and emerging projects or issues. The policy, which is also codified in the City Code (Section 18-100.2), states, "Fifteen percent (15%) of General Fund recurring revenue growth, excluding one-time revenues, and any debt service savings resulting from bond refinancings of City capital projects shall be dedicated annually to this reserve. One third of the balance of this reserve shall be used for economic development activities, and two-thirds shall be used for emerging issues." Complying with the policy in FY 2003 would require setting aside approximately \$50,000 from the General Fund with \$16,500 going towards economic development activities.

The Reserve for Accrued Compensation was established to address those years that include 27 payrolls. This was mainly an accounting issue and, since full payroll is budgeted on a fiscal year basis, the reserve is proposed for elimination. It is recommended that the balance of \$580,000 in the reserve be returned to the General Fund

The Reserve for Streets and Bridges serves for pay-as-you-go financing for street and bridge capital projects. Designated funds are subsequently transferred to the Capital Fund.

The Public Works Reserve was a source of pay-as-you-go financing for capital projects. After the adoption of the FY 2002 Budget this reserve was eliminated and resources consolidated with the Capital Projects Fund.

The General Fund Reserve for Contingencies funds expenditures unanticipated during budget development. Any funds remaining in this reserve at the end of the fiscal year revert to the General Fund Balance. The Financial Management Policies call for a contingency amount equal to approximately two percent (2%) of departmental and non-departmental appropriations. Subsequently, City Council adopted a policy goal of having \$1.2 million in this reserve. The *Proposed FY 2003 Budget* meets this goal.

The Self-Insurance Reserve was established to settle liability insurance claims filed against the City in lieu of insurance. Although the City has had a very favorable claims experience, our insurance consultants have suggested increasing the reserve balance from the present \$2.0 million to \$3 million. The *Proposed FY 2003 Budget* does not provide a contribution to increase this reserve.

### Use of Fund Balance

Proposed expenditures and transfers of \$118.0 million exceed annual revenues of \$116.8 million by \$1.2 million. Consistent with City Council's policy, fund balance in excess of the 10% target can be used for pay-as-you-go capital expenditures, other non-recurring expenditures or as additions to fund balance. The *Proposed FY 2003 Budget* includes \$1.2 million in pay-as-you-go capital financing for the following projects: Street and Utility Extensions (\$150,000) and General Development Support (\$200,000) designated for economic development initiatives; Furniture, Fixtures, and Equipment for Human Services relocation to 822 Commerce Street (\$528,000); College Hill Community Center Renovation matching funds (\$8,600); Diamond Hill Community Center Renovations (\$23,500); Parks Paving and Lighting Improvements (\$125,000), a Master Plan for College, Perrymont, and Younger Parks (\$30,000); and, Playground Equipment Replacement and Improvements (\$168,000).

### Undesignated General Fund Balance

The City's Financial Management Policies call for an Undesignated General Fund Balance to be "maintained at a level to provide the City with sufficient working capital and a comfortable margin of safety to address emergencies and unexpected declines in revenue without borrowing." A minimum balance of 7% of General Fund revenues with a target of 10% is stipulated. The *Proposed FY 2003 Budget* exceeds the Undesignated General Fund Balance target. The fund balance at the end of FY 2003 is anticipated to be \$13.8 million, for a ratio of just over eleven percent (11.34%). This leaves approximately \$1.5 million that Council could program for non-recurring expenditures.

### Personnel

As with any service organization, the largest part of the City's operating budget is devoted to employee compensation through wages, salaries and benefits. During its goals setting process, City Council confirmed the value of competitive employee compensation in recruiting and retaining a qualified, competent and diverse workforce capable of maintaining excellent core services. The City continues efforts to promote workforce stability and has experienced acceptable voluntary turnover rates and positive recruiting experience for most vacant positions. This has been particularly true during the

current recession when many job seekers turn to the public sector for what are perceived as good benefits and a stable work environment. How long local government employment will enjoy this reputation is an open question.

The foundation of the City's compensation plan rests on the goal of attracting and retaining employees that are qualified, competent and representative of the community through pay ranges anchored by midpoints that closely match the average pay in the relevant labor market. To measure the competitiveness of the pay structure, the Human Resources Department conducts periodic surveys of selected benchmark positions and compares pay ranges and average employee pay to calculated market averages. Past results have indicated that the City's overall pay structure, as reflected by its published pay ranges, is competitive with comparable organizations and is reflective of Council's prior actions in support of the pay philosophy. Nevertheless, from time to time market comparisons and analysis of turnover and recruitment experience indicate the need to adjust specific positions. In the *Adopted FY2002 Budget*, \$99,690 was included for such adjustments. The *Proposed FY 2003 Budget* includes only \$4,612 for adjustments.

As the needs of the City change, the specific duties and responsibilities of some positions change as well. In the past, some funds have been set aside to ensure market competitiveness as duties change. The *Adopted FY 2002 Budget* included \$69,668 for reclassifications. The *Proposed FY 2003 Budget* does not include any resources for this purpose. Instead, departments will be expected to document the need for reclassifications and include requests for funding in future budget submissions.

While competitive pay ranges are vital to the recruitment and retention of a qualified workforce, actual employee pay is also critical to maintaining high performance and productivity. Market analysis has indicated that the overall average pay for City employees is seven to ten percent (7-10%) below the average pay for similar jobs in the relevant labor market. A 3% base pay increase, costing \$1.2 million, was considered for all classified employees who demonstrated satisfactory performance. At best, this would have maintained the relative disparity between City employee pay and the market. In light of the combined impact of the national recession and the state budget situation on local revenues, the proposed salary increase has been eliminated. If additional resources are identified during the budget deliberations, this is an area that City Council is strongly encouraged to address.

The City continues to experience rising Health Benefit costs due to industry-wide increases in medical services and prescription drugs. It is projected that a twelve percent (12%) increase in funding for active employees will be required at a cost of \$240,000. Funding for the increase is included in the *Proposed FY 2003 Budget*. The enterprise funds will also see proportional increases. In addition, costs for retiree medical and dental benefits are expected to rise approximately \$150,000. Suggestions on steps that might be taken to control medical costs and/or shift more of the cost to the actual users of medical services will be shared with Council during budget deliberations.

Twenty-one (21) new employees were requested for funding by various departments. Those positions are highlighted in the budget document's individual department discussions. The only new positions that the *Proposed FY 2003 Budget* supports are two (2) custodians, for three months, to support the relocation of the Human Services Department to the J.W. Ould building at 822 Commerce Street. Furthermore, we propose the elimination of four positions, Fiscal Planner, Project Manager in Engineering, Accountant III and Volunteer Coordinator (part-time), and the deferral of filling the Assistant City Manager position.

With these proposed adjustments, the City's workforce would total 1298.34 employees. This includes 1,151.35 full-time classified, 42.84 part-time classified, 38.15 grant positions and 66 state positions. In addition, the City supports 18 additional grant positions not yet reflected in this document.

### **Fleet Services Fund**

Beginning in FY 2001, an Internal Services Fund was created to manage the City's fleet of over 600 vehicles and equipment. The Fleet Services Manager reports to a Board of Directors consisting of representatives from various departments that utilize fleet services. FY 2002 was Fleet Services' first full year of operations in new garage facilities. The total operating budget of \$4.3 million for Fleet Services is an increase of 9.4% percent from FY 2002. The most significant increases are for parts and debt service on large fire and rescue equipment.

A General Fund transfer of \$623,000 is provided for fleet replacement in FY 2003. This represents an increase from the \$500,000 provided in FY 2002. Due to fiscal constraints, we have not been able to begin factoring an equipment depreciation component into the annual charges to departments for fleet replacement.

### **Capital Fund**

The FY 2003 Budget process has included a complete reconstruction of the Capital Improvements Program (CIP) to more accurately reflect a schedule based on existing cash and staff resources and debt capacity. The *Proposed FY 2003-2008 Capital Improvements Program* includes \$60.0 million for general capital projects and \$45.6 million for school capital projects. The proposed CIP will be the subject of detailed discussion during an upcoming budget work session. Ultimately, Council will be asked to rescind all previous appropriations to the Capital Fund and then to reappropriate funds for FY 2002. Adoption of the *FY 2003-2008 Capital Improvements Program* is anticipated with coincident with adoption of the annual budget. Major projects proposed for funding in FY 2003 include Holiday Inn Parking Deck Improvements, Monument Terrace Renovations, Old Courthouse Renovations, Old Graves Mill Road Relocation, Major Bridge Repairs, various Parks and Recreation improvements as well as Roof Replacements and Major Building Repairs.

### **Airport Fund**

The Lynchburg Regional Airport is budgeted as a separate fund to clearly delineate its financial operation and the support from the General Fund. Total expenditures of \$2.2 million are covered by Cost Center revenues and a General Fund subsidy of over \$800,000. The FY 2003 transfer from the General Fund is projected to increase \$221,000 or 36% from the *FY 2002 Adopted Budget*. A significant decrease in Cost Center revenues is attributable to the national trend of lower passenger demand and the loss of scheduled airline service. This affects landing fees, rental car concessions, and fuel flowage fees. FY 2003 operating expenditures are projected to be basically unchanged, with a significant increase for additional security services (\$90,000) balanced by various reductions. Although there is a possibility that federal funds will offset some of the security cost, nothing definitive has been received.

## **Water Fund**

The City's water system can be characterized as having low rates, ample capacity, and positioned for significant growth opportunities in its customer base. In addition to serving approximately 20,500 City accounts, water is sold by contract to the counties of Amherst, Bedford and Campbell and to several large industrial customers (Rock-Tenn, Frito-Lay and Griffin Pipe). The Water Fund operates as an enterprise fund and requires no subsidy from the General Fund.

Water Fund total revenues are projected to decrease slightly from \$8.5 million to \$8.2 million while expenditures remain relatively unchanged at \$8.5 million. The difference will be made up from existing funds. One Utility Operator position is proposed to be eliminated in FY 2003. Revenues from Charges for Services are expected to fall from \$6.5 million to \$6.3 million even after implementation of a proposed three percent (3%) rate increase. The revenue decrease is primarily attributable to reduced demand from large industrial customers. This reduction in demand, along with moderate increases in costs, necessitated the proposed rate increase that is designed to maintain the fund balance and debt coverage ratio at levels that meet the financial policies established by City Council. With the rate increase recommended by the City's utility rate consultant, Pricewaterhouse Coopers, the fund balance is projected to be 47% of total fund expenditures for FY 2003 with a debt coverage ratio of 1.28. Both of these measures will fall slightly from FY 2002 but will remain in compliance with City Council's policy to maintain a fund balance at 40% of annual fund expenses and a debt coverage ratio of no less than 1.2.

A significant capital project in FY 2003 will be the upgrade of existing lines and the extension of service along U.S. Route 460 East to serve industrial development in the Mount Athos area of Campbell County. Cost for this work is estimated to be over \$4 million. Once the line is active, the City expects to see the additional sale of over 2.5 million gallons of water a day to the Campbell County Utilities and Service Authority.

## **Sewer Fund**

The City's sewer system serves both Lynchburg and portions of the surrounding counties. Although operated by the City, the wastewater treatment plant is a regional asset with capital costs shared by the localities proportionally. The City has contracts with several large industrial users (Rock-Tenn, Frito-Lay, Griffin Pipe and Westover Dairy). The Sewer Fund is also operated as an enterprise fund and requires no subsidy from the General Fund.

The *Proposed FY 2003 Budget* projects revenues of \$15.1 million against expenses of \$15.5 million with the difference made up from existing funds. One Utility Operator is proposed to be eliminated in FY 2003. Revenues are projected to increase 2.9% and expenditures are projected to increase 7.6% over the current budget. The net revenue increase is a combination of an actual loss of revenue from large industrial users and a proposed rate increase of ten percent (10%). The combined effect of proposed rate increases in both the water and sewer funds is anticipated to be about 7% on the average customer's monthly bill. The level of rate increase is intended to maintain the fund balance and debt coverage ratio at levels that ensure compliance with a Special Order between the City and the

Department of Environmental Quality (DEQ) for the correction of Combined Sewer Overflows (CSO) and to provide for increased operating and debt service costs.

The special order with DEQ establishes a compliance schedule and project priorities for implementation of the CSO control plan. Although the City has spent over \$120 million on CSO control since 1993, the estimate to complete remaining necessary work is over \$200 million. The compliance schedule does not contain fixed dates for implementing the CSO control plan, but rather provides for implementation based on three criteria that reflect the limits of the City's financial capability. These criteria are:

1. The City is required to maintain rates so that the annual sewer bill for the average residential customer, using 9 hundred cubic feet (hcf) a month, equals or exceeds 1.25% of median household income (MHI).
2. The City is required to maintain a sewer operating debt coverage ratio within a range of 1.15 to 1.5.
3. The City is required to have reserve funds equal to no more than 25% of the prior year's budgeted operating expenditures.

With the rate increase recommended by the City's utility rate consultant, Pricewaterhouse Coopers, the fund balance is projected to be 20% of fund expenses for FY 2003, with a debt coverage ratio of 1.17, therefore meeting the criteria defined by DEQ. When MHI data compiled by the 2000 Census is released, it is expected that the criteria that the annual sewer bill equal or exceed 1.25% of MHI will be greatly surpassed. Currently it is believed to be approaching 1.50%.

Expenditure growth in the Sewer Fund is for debt service (\$700,000) and additional operating expenses in the areas of sludge disposal, chemicals, and utilities (\$400,000). Placing the new odor control facilities in operation will be responsible for much of this increase.

Due to the fiscal challenges facing the Sewer Fund, even after a rate increase, there is little capacity for starting new capital projects. The lack of state matching funds for CSO work will also have an impact on the City's ability to utilize federal grants.

### **Solid Waste Management Fund**

The Solid Waste Management Fund is established as a self-supporting enterprise fund. The fund assesses solid waste disposal costs through a tipping fee at the landfill and a decal system for residential collection. Collection costs are covered through a General Fund Transfer of over \$700,000.

FY 2003 revenues are projected to be \$5.8 million against expenses of \$6.5 million. This continues a trend of using reserve funds to close the gap. While expenses are expected to fall slightly, revenues will also fall due to rate discounts provided to large commercial waste haulers, such as BFI, and a loss of interest revenue due to the use of fund balance and lower interest rates.

In August 1999, City Council adopted financial policies that established a debt coverage ratio of no less than 1.2 and fund balance targets of 40% of annual fund expenses for enterprise funds. The

*Proposed FY 2003 Budget* will not meet the debt coverage ratio target without a rate increase. It is projected that this coverage will fall to 1.08 with the current fee structure. Out year projections indicate that the fund balance, while projected at 72% for FY 2003, will fall below the policy guideline within a few years. With this awareness, last year City Council directed a rate study of the Solid Waste Management Fund. The study, which explores alternate mechanisms to both charge for waste disposal and to eliminate the over \$700,000 General Fund transfer for collection, will be shared with Council during budget deliberations.

### Outstanding Issues

There are a number of outstanding issues that may impact the budget deliberations or that will require discussion during the process.

- The General Assembly's adoption of a "caboose" bill for the FY 2002 Budget and agreement on the FY 2003/2004 Budget will bring to light further impacts on local finances. It can be expected that revenues for Constitutional Officers, education, human services and public safety will be impacted. An issue for Council will be to what extent local funds should be used to cover any loss of state revenues. Doing so would require shifting resources from other areas of the proposed budget.
- Employee compensation and possible salary increases for both City and School employees will be of great interest to the workforce.
- The Solid Waste Management Rate Study will challenge Council to consider a significant rate increase and the possibility of an entirely different approach to funding these operations.
- The costs of providing health benefits to City employees and retirees continue to rise sharply. Council will be given suggestions on possible cost containment or cost sharing measures.
- The Juvenile Detention Center is projected to end the current fiscal year with a deficit of nearly \$250,000 and that deficit is not projected to go away in FY 2003 without an adjustment in per diem charges to the Center's users.
- An examination should be commenced to determine if there is a reasonable and fiscally prudent way to lessen the reliance of the water and sewer funds on a few large industrial users. That reliance results in vulnerability and a lack of predictability as the industries modify or eliminate processes that have high demands for water and sewer service.
- The CSO program will come to a virtual standstill without additional resources from the state and federal government. The financial standards set by DEQ in the consent order are already being exceeded. The City has little ability to finance additional CSO projects without a significant rate increase.
- Certain actions to enhance revenues without a tax increase should be explored.



## **Outlook**

Despite the national recession, the state budget crisis and the considerable challenges facing the Commonwealth's older core cities, we remain stubbornly optimistic. Lynchburg celebrates its 150<sup>th</sup> anniversary as an incorporated city in 2002. During that time there have been many challenges where an informed and active citizenry, along with the leaders they elected, worked together to prevail. Today requires a similar effort.

Although the national recession may be abating, the state fiscal situation is seriously periled. Indications are that action taken by the General Assembly, because of their one time nature, will not correct the fundamental problem of inadequate revenues to finance ongoing costs. A basic principle of budget management, one that is in the City's Financial Management Policies and was followed with difficulty in the development of this budget proposal, is that annually recurring expenditures must be covered by annually recurring revenues. The only way to achieve the necessary balance is to control (cut) expenditures or raise revenues. Not doing so is fiscally irresponsible. Unfortunately, the general public seems to have either never fully understood or has forgotten that principle. The message that is conveyed to elected officials at all levels is an expectation that taxes can be cut while expenditures rise. In a longer term macro-economic sense, some of that may be true, but it loses its applicability at the state and local level where measurable services must be delivered to the public each year.

We believe that the fallout from the state budget situation and the impact on services from actions taken at the state and local level will prompt a re-examination of the roles and responsibilities of each level of government and how desired services should be paid for. Lynchburg will continue to work with the Virginia First Cities Coalition to address the structural inadequacies in the Commonwealth's governmental and tax structure. Calls for a special General Assembly session on these issues are already starting.

Closer to home, the revision of the City's Comprehensive Plan offers an opportunity to influence the pattern of development and redevelopment throughout the City. As that important work concludes, special attention should be paid to ensure that the plan promotes quality economic development that will enhance the quality of life of our residents and the tax base on which we depend to finance important services. One important step in support of economic development would be the adoption of the Technology Zone Ordinance currently under consideration to support new business investment downtown and in the Lynchpin Industrial Park.

A bright spot is the growing interest and investment in Lynchburg's downtown. City Council's adoption of the Downtown Plan and its willingness to provide support to private development initiatives strengthen the promise of a successful revitalization of a viable downtown community that will benefit the entire City and region. Projects that are moving ahead include Ninth Street improvements, the renovation of the J. W. Ould building for Human Services, a new federal courthouse and post office, the Academy of Music, Riverviews and Bluff Walk. All will complement the success of Amazement Square and City efforts to restore important downtown landmarks such as Monument Terrace and the Old Courthouse.

The activity downtown will soon be further complemented by the planned renovation of E.C. Glass High School and ongoing efforts to maintain the quality of all of the physical resources of the City's school system.

Finally, we want to take the opportunity to make a pitch for the City's workforce. In the end, it is the City employees that put the annual budget into action for the benefit of Lynchburg's citizens. These folks have been asked to "do more with less" and they have delivered out of a strong commitment to public service. And there will be fewer of them in the future. We will continue to strive to give City employees the tools and technology that will allow them to fulfill their responsibilities in the most effective and efficient manner. Once all that is done, however, and while the present fiscal challenges preclude a salary increase in FY 2003, our commitment to recruiting and retaining excellent employees can only be met by providing fair compensation and benefits.

### Conclusion

The *Proposed FY 2003 Budget* is offered for City Council consideration, deliberation, amendment and adoption. In our judgement, it presents to you a balanced approach in a constrained and uncertain fiscal environment. This budget proposal remains a work-in-progress. Over the next several weeks, Council will have the opportunity to hear from and question the representatives of the various departments and agencies seeking funding in FY 2003. A public hearing on the proposed budget is scheduled for April 16, 2002 in Council Chambers. During your deliberations, staff is prepared to provide assistance and additional information as you work towards budget adoption.

### Acknowledgements

The development and production of the *Proposed FY 2003 Budget* faced practical as well as financial challenges. With the absence of the City's Budget Director due to a critical illness, many individuals stepped forward to offer their time and talents.

We extend special thanks to Kathy Scott and Kim-Chi To in the Budget Office for their countless hours of developing and producing this document; to Michael Hill, Financial Services Director, for his leadership and guidance in the development of the enterprise and other funds components; to the team of Accountants who crunched numbers and balanced all of the City's funds; and, to Missy Cunningham, Accountant III, for providing revenue projections upon which this budget was developed. We are also particularly grateful for the extra effort contributed by Greg Daniels, City Assessor, and Donna Witt, Billings and Collections Supervisor, who accepted the challenge of balancing their daily responsibilities with service as Budget Analysts; thank you for going above and beyond the call of duty.

Finally, while this budget faced huge obstacles from both the perspective of providing you with a document that is fiscally responsible and from a production capability perspective, we are very proud to work with employees throughout the City who understand and are prepared to face the fiscal challenges of today and those yet to come.



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